UNEMPLOYMENT CRISIS

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UNEMPLOYMENT CRISIS

THURSDAY, DECEMBER 9, 1982

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Henry S. Reuss (chairman of the committee) presiding.

Present: Representatives Reuss, Mitchell, Hawkins and Wylie; and Senators Jepsen and Sarbanes.

Also present: James K. Galbraith, executive director; Bruce R. Bartlett, deputy director; Louis C. Krauthoff II, assistant director; Charles H. Bradford, assistant director; and William R. Buechner, Mary E. Eccles, Paul B. Manchester, Mark R. Policinski, and Nathaniel Thomas, professional staff members.

Representative REUSS. Good morning. The Joint Economic Committee will be in order. We welcome Mr. Martin Feldstein, Chairman of the Council of Economic Advisers, to the first of what I know will be many productive sessions with the Joint Economic Committee.

Mr. Feldstein, you join a goodly company of great Council Chairmen over the years and it might interest my colleagues if I read their names to refresh myself: Edwin G. Nourse, Leon H. Keyserling, Arthur Burns, Raymond Saulnier, Walter Heller, Gardner Ackley, Arthur Okun, Paul McCracken, Herbert Stein, Alan Greenspan, Charles Schultze, and Murray Weidenbaum. As I say, splendid company, and we welcome your joining it and I know that you're going to do a fine job.

I have a rather short opening statement but first I would like to yield to my friend and colleague, Vice Chairman Jepsen.

OPENING STATMENT OF SENATOR JEPSEN, VICE CHAIRMAN

Senator JEPSEN. Thank you, Mr. Chairman. It is a pleasure to welcome Mr. Feldstein to his first appearance before the Joint Economic Committee as Chairman of the President's Council of Economic Advisers. We have, of course, had you before the committe on numerous past occasions as a professor of economics at Harvard, and I look forward to a close working relationship in the future.

I congratulate you on yesterday's final Senate confirmation of your appointment and was happy to be able to cast a yes vote. It is unfortunate that your scheduling conflicts prevented your appearance before the committee at an earlier date, and equally unfortunate that it became a political issue. I am certain that no disrespect was intended toward the Congress or this committee by your inability to appear earlier.

In any case, I am glad to see you here today to discuss the important economic issues facing our country today. Although there are important signs that recovery has begun, the unemployment rate continues to rise. This, in turn, is putting enormous pressure on Congress to enact quick-fix programs which, I fear, will end up being counterproductive in the long run. If you have any ideas on how we can deal with the unemployment problem without re-igniting inflation or undoing the progress we have made toward reducing taxes and the size of government, I would be very pleased and happy to hear them. I realize this is a tall order, but I hope you can enlighten us today.

I thank you, Mr. Chairman.

Representative REUSS. Thank you, Mr. Vice Chairman. We do face an unemployment crisis. At this time, I will present my opening statement.

OPENING STATEMENT OF REPRESENTATIVE REUSS, CHAIRMAN

On February 18, 1981, President Reagan sent to Congress his program for economic recovery. He predicted that under that program, unemployment would fall from 7.5 percent in 1981 to 7 percent in 1982. A year later—by early 1982— the unemployment rate had increased, however, to 8.8 percent. The President's economic report issued last February counseled patience, saying, "Output and employment are expected to increase slightly in the second quarter, and at a brisk pace through the rest of the year, when growth in output is expected to be in excess of a 5 percent annual rate."

Five months later—last July—unemployment had increased to 9.8 percent. Again we were told in the administration's midsession review to be patient, and I quote: "During the second half of 1982, the economy is expected to grow at about a 4-percent inflation adjusted annual rate."

Now unemployment stands at 10.8 percent. It may even be rising now. Real gross national product did not grow at 5 percent nor at 4 percent in the third quarter. It didn't grow at all. There are signs that total output may be falling in the present quarter.

Chairman Feldstein, you have a reputation for forthrightness. You acknowledged the failure of extreme monetarism and extreme supply-side-ism in your confirmation hearings. I don't expect to hear from you the same kind of reassurance that things will get better—while all the while they continue to get worse—that we have been hearing for a couple of years. I do expect to hear what changes in the extreme monetarist and extreme supplyside policies presently in effect you may recommend.

Congress has before it a program which could begin to address the unemployment crisis. I expect that Congress will enact that program this year. I urge the President to sign it into law.

Perhaps you could begin this morning, Chairman Feldstein, by giving the committee your present assessment of the prospects for real growth, for unemployment and for interest rates in the year ahead. Then I would like your comments on some of the economic choices now facing the Nation.

Before we ask Mr. Feldstein to proceed, I have an opening statement from Congressman Clarence Brown that I will insert into the record at this point, without objection.

[The opening statement referred to follows:]

OPENING STATEMENT OF REPRESENTATIVE BROWN

Welcome, Mr. Feldstein, to this Joint Economic Committee hearing. You are continuing the tradition of cooperation between the Joint Economic Committee and the Council of Economic Advisers.

I feel very fortunate that you are appearing before us today when you will be appearing before us in the next month or so as part of our Joint Economic Committee annual hearings. I think that this morning marks the 12th appearance by the Council of Economic Advisers before this committee during this Congress and no committee has enjoyed greater cooperation from the Council of Economic Advisers.

Representative REUSS. Mr. Feldstein, you may proceed.

STATEMENT OF HON. MARTIN S. FELDSTEIN, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Mr. FELDSTEIN. Thank you very much, Mr. Chairman.

I certainly am very pleased to appear before this distinguished committee this morning. I have great respect for the Joint Economic Committee and for the work it has done over the years to develop an understanding of our Nation's economic problems and to formulate new approaches to these problems.

As you said, this is my first opportunity to testify since my appointment as Chairman of the Council of Economic Advisers and my confirmation by the Senate. I welcome this opportunity to work with the members of this committee and look forward to future sessions with the committee. I'm sorry, Chairman Reuss, that after this session of Congress you won't be a member of the committee and we won't have the opportunity to meet together again in this format as we have in the past.

I know that the committee has questions this morning about a wide range of economic issues but none of these issues can be more pressing or of greater immediate concern than the very serious unemployment problem that our Nation faces.

As you know, the administration is currently reviewing several proposals for policy changes that can reduce the rate of unemployment. Since no decisions have been made, it would not be appropriate for me to comment in detail on the specific features of any of these proposals, but I thought it would be helpful if I talked for a few minutes about the nature of unemployment in the U.S. economy as I see it and therefore about the opportunities for reducing unemployment.

The key distinction in my analysis of unemployment is the difference between cyclical unemployment that would be eliminated by an economic recovery and structural unemployment that would remain even after the economy had fully recovered.

Between 30 and 40 percent of the current 10.8 percent unemployment rate is cyclical and the remainder is structural. I will begin by commenting on the cyclical component of total unemployment.

The last sustained business cycle expansion began in March of 1975 and continued for nearly 5 years to a business cycle peak in January 1980. Since then, the economy has suffered the effect of two back-to-back recessions. This double-barreled decline has had the painful effect of raising the unemployment rate from 6.3 percent then to 10.8 percent now.

There are now about 5 million more people looking for work than there were in January of 1980. The increase in long-term unemployment has been particularly severe. In January of 1980, there were about 550,000 individuals who had been unemployed for 6 months or longer. Now there are four times as many. No one can contemplate such numbers without reflecting on the financial hardships that so many people have suffered.

Moreover, financial losses are only a part of the cost of the prolonged economic decline. There is also the extreme anxiety that is felt by those who have lost their jobs or who fear that they might lose their jobs in an economy with a shrinking number of employment opportunities. Only an economic recovery can eliminate the large bulge of cyclical unemployment and the widespread anxiety that now accompanies it. I wish I could tell you that I know for sure that the recovery has begun and that unemployment will soon be declining. Unfortunately, though, the economy is still in that ambiguous bottoming-out range of the business cycle.

The economy is still relatively weak, but favorable signs of an upcoming recovery are getting stronger all the time. These favorable signs include an upturn in housing starts to a level that is now some 30-percent higher than at this time last year. A 33-percent jump in housing permits since August indicates that housing is likely to continue improving. Auto sales are also rising, and retail stores report good news about major consumer durables.

The preconditions for sound recovery, including lower interest rates and significant growth of the real money stock, make the current outlook far better than the outlook was 1 year ago or even 6 months ago. A sustained recovery will bring with it rising employment and falling unemployment. The type of moderate and sound recovery that is consistent with declining inflation can bring the unemployment rate down to the 6- to 7-percent range within the next 5 or 6 years. A faster recovery runs the risk of accelerating inflation and therefore of igniting an expansion that comes to a premature end.

Bringing the unemployment rate down from its current level to the 6- to 7-percent range means finding employment for about 5 million people who would otherwise be out of work. Moreover, the natural growth of the labor force means that more than 10 million additional jobs must be created to avoid an increase in unemployment. These numbers will make it clear why I said a moment ago that only a sustained economic recovery can eliminate the cyclical bulge in unemployment. No series of public employment programs or other government activities can begin to create more than 15 million additional positions during the next half dozen years.

Before turning to the nature of the structural unemployment problem, I might take a moment to comment on the technical question of how unemployment is defined and then to look briefly at some of the characteristics of the unemployed.

As you know, all of our principal unemployment statistics are based on the monthly Current Population Survey of about 60,000 households. The Labor Department classifies an individual as unemployed if he or she has not worked during the week before the survey and has done something during the past 4 weeks to look for work.

There are obviously many facets of unemployment that must be understood in order to have a complete picture of the problem and of the possible remedies. This morning I can only call your attention to five key facts that I think are particularly important.

First, 40 percent of all the unemployed are now under the age of 25. Nearly half of this group are teenagers. Moreover, when the overall unemployment rate is lower than it is at present, young people account for even larger shares of the total unemployment. In 1979, when the overall unemployment rate was 5.8 percent, teenagers alone accounted for 25 percent of total unemployment. Since then, the number of unemployed teenagers has increased approximately 30 percent, while total unemployment has increased approximately 90 percent. In short, unemployment among young people is quantitatively very important and much less cyclically sensitive than unemployment among the rest of the population.

Second, less than half of the unemployed have lost their previous jobs and are looking for new employment elsewhere. In October of 1982, 30 percent of the unemployed were classified as either new entrants who were looking for their first job or reentrants who had returned to look for work after a period in which they were neither working nor looking for work. An additional 7 percent of the unemployed had quit their previous job. And a further 22 percent were classified as on layoff from their regular job but waiting to be recalled to that job. Thus, only 42 percent were actually classified as job losers who were not waiting for recall. In times of lower unemployment, the relative importance of new entrants, reentrants, and quitters is greater, and these groups together then comprise the majority of the unemployed.

Third, most spells of unemployment end quickly. Despite the severity and duration of the present recession, nearly two-thirds of the current unemployed have been out of work for less than 15 weeks. Half of the individuals who became unemployed in July were no longer unemployed after roughly 6 weeks.

But, fourth, although most spells of unemployment end quickly, a small fraction of all unemployed individuals accounts for a large fraction of the total weeks of unemployment. A study of the 1975 recession that was done a few years ago found that although only about 4 percent of the labor force experienced more than 26 weeks of unemployment in that year, that small group accounted for over 50 percent of total weeks of unemployment during the year. Thus there is a concentrated problem of long-term unemployment that is critical to bringing down the overall unemployment rate.

Finally, although the long-term unemployed in key declining industries accounts for only a small percentage of total unemployment, they do represent cases of serious personal economic hardship. More specifically, there are now about 150,000 individuals who have been unemployed for more than 6 months and who previously worked in autos, textiles, rubber, iron, or steel. This group thus represents only

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about 0.15 percentage points of the total 10.8 percentage points of unemployment. Nevertheless, these long-term unemployed individuals in industries with decreasing employment must be regarded as an important challenge to economic policy. This is all the more true because in addition to the 150,000 long-term unemployed in this category, there are an additional 300,000 individuals from these industries who have stopped looking for work and are therefore classified as out of the labor force.

The future path of the unemployment rate will depend on the behavior of both cyclical and structural unemployment. A sustained recovery can reduce the cyclical unemployment rate and return the total unemployment rate to the inflation threshold level. Additional policies aimed at structural unemployment can reduce the inflation threshold level of unemployment below the current 6- to 7-percent range. A reduction in structural unemployment would not only lower the ultimate inflation threshold range of unemployment, it would also permit a more rapid decrease in total unemployment during the next few years in a way that is consistent with not increasing our rate of inflation.

Now, what conclusions about appropriate unemployment policies follow from what I have been saying about the nature of cyclical and structural unemployment? It is clear that there is no justification for public employment projects and other activities that are designed solely to create jobs rather than to provide useful products for services. President Reagan and Transportation Secretary Drew Lewis have been very clear in emphasizing that we favor a major program of highway and bridge repairs because of the sorry state of many of our Nation's highways and bridges and not as a way of increasing employment.

A major part of our structural employment problem is concentrated in the group aged 16 to 24 years who now make up 40 percent of all unemployment. The unemployment in this group reflects problems in the transition from school to work. Moreover, the problem goes beyond unemployment to the kinds of jobs that young people often obtain. The frequent job changes that contribute to their high unemployment rate indicate that many young people are working in dead-end jobs that fail to provide opportunities for training and advancement. The challenge to public policy is not only to help more young people find jobs but to improve the quality of the jobs that young people find and hold.

The administration has already taken some important steps in that direction. The new Job Training Partnership Act that Congress passed and the President signed into law will pay for the training of young people from low-income families. In addition, a special targeted jobs tax credit would pay up to 85 percent of the summertime wages of teenagers from disadvantaged backgrounds. We are now examining a variety of new ideas to see which, if any, would be suitable for dealing with the special problems of young workers.

A second major aspect of our structural unemployment problem is represented, as I said a moment ago, by those individuals with very long spells of unemployment. This group includes both chronically unemployed adults with low skills and those skilled workers who have lost their jobs in declining industries and regions. The recent Job

Training Partnership Act has separate provisions for supporting training of the first group and retraining of the second group. But the administration is looking again at possible additional ways of enhancing employment opportunities for both of these groups.

Let me conclude on a more general note. The current recession has heightened interest in the problem of unemployment and focused attention on the cyclical aspects of that problem, but it is critical that we manage economic policy in a way that will reduce both cyclical and structural unemployment. Our goal should be to reduce unemployment steadily to a rate that is well below the present 6 to 7 percent inflation threshold. To do so the administration will be engaged, not just now but on a continuing basis, in the development of policies to reduce the inflation threshold rate of unemployment and to expand the opportunities for providing employment.

Thank you, Mr. Chairman.

Representative REUSS. Thank you, Chairman Feldstein. You gave an upbeat report, saying on page 9 of your prepared statement at your confirmation hearing before the Senate Committee on Banking, Housing, and Urban Affairs on September 22, 1982, "The economy now seems about ready to recover."

I guess I can't be quite as happy about that prediction from the President's Council of Economic Advisers as I would like to be in view of the fact that every year, twice a year—in February and in July—the Council has been announcing that the economy is about ready to recover and unemployment is going to go down, while instead the economy sinks deeper into recession and more and more men and women become unemployed.

What is different about the present situation which causes you to feel as you do that the economy is now about ready to recover?

Mr. FELDSTEIN. Let me comment first that the forecast you referred to indicating that Government economists thought that there would be a recovery earlier last year, a recovery beginning in the late part of this summer, were forecasts that were very widely shared. That is a black mark against the forecasting ability of the economic profession rather than against the administration. Most economists felt that we were going to have an upturn early in 1982, or if not early in 1982 then by the third quarter, and you see that in virtually all of the private forecasts. The administration, I think, was not any different from private forecasters in its qualitative forecasts in this year. But I do think the conditions are rather different now and offer much more basis for hope than they did earlier.

Representative REUSS. Why is that?

Mr. FELDSTEIN. First, there is the actual performance of the economy in key sectors. Housing has begun behaving differently. I think that the continuing decline in mortgage interest rates that began in midsummer, so that mortgage interest rates are 3 or 4 percentage points lower now than they were earlier this year, and even lower than they were at the beginning of the year and the end of last year, has had a very substantial effect. And a 30-percent increase in housing starts now relative to where they were a year ago, and an even faster growth of housing permits in recent months.

I think that not only is this indicative of where housing can go but also of where the consumer durables industry, which is associated with

housing, could go as well. The recent figures on sales and on the inventory of new unsold housing stock, also are very encouraging for the future.

The leading indicators which summarize a variety of measures, financial and real, employment to production and orders—have picked up in 6 out of the last 7 months. While no single month's increase has been very large, the cumulative effect is very reassuring because those indicators tend to move up before the rest of the economy turns up. I think that while the current state of the economy is, as I said, very weak, there are encouraging signs that the conditions are there for the economy to begin to recover.

Representative REUSS. I appreciate your detailing for us, and it is helpful, why you feel encouraged, but I wish you would tell me why the Council of Economic Advisers—and you were not a member of it then, I hasten to point out—in each of the three opportunities it has had so far to tell us what the future would be, predicted recovery and lower unemployment and got deep recession and increased unemployment instead. Wherein did they err so grievously?

Mr. FELDSTEIN. As you said, I was not there and I therefore can't really comment on the process. But I would just reiterate that if you look at any of the surveys of private forecasters or the major econometric forecasting organizations, I think you would find that they, too, predicted an upturn in the second quarter of 1982. Then when it didn't come they predicted that in the months after the tax cut this year there would be an upturn—beginning in July or August. So, the administration was not saying anything very different from what the majority of private forecasters of all analytic persuasions were saying at the same time.

Representative REUSS. What is your best estimate of the growth rate of real GNP for 1983?

Mr. FELDSTEIN. At this point the administration is in the process of formulating a set of forecasts which we will use as part of the budget exercise which will be presented to you and Congress when the Economic Report comes out in January. At this point we really don't have a forecast that we can make public.

Representative REUSS. Well, then, let me ask you this. In your testimony before the Senate at your confirmation hearing in September, you indicated that a growth rate of somewhere in the 3-percent range was about it. Is that still your formal hunch?

Mr. FELDSTEIN. What I did in September was to quote a survey of private forecasts, and I pointed out that half of the forecasts were then between, I think, 2.9 percent and 3.9 percent for 1983 over 1982. That was based upon the Blue Chip Survey of 44 private forecasters that was released early in September.

Now since then, that group has reduced its forecast. I never made a forecast in September. I thought I went out of my way in September not to make a forecast but just to summarize what private thinking was at the time and to say I thought these were a bunch of very serious, competent people who put a lot of effort into it. That same group of forecasters have reduced their forecasts by an average of about half a percent.

Representative REUSS. So since their forecast was about 3.5 percent, their composite is now around 3 percent?

Mr. FELDSTEIN. I think that is about right for their consensus. I might add a little more about that, though. What is critical in thinking about any of these forecasts at a time like this, when you are near a turning point in the economy, is the question of the timing of when the recovery begins. Most economists believe that when the recovery begins there will then be a significant—one higher than 3 percent—rate of growth in the months that follow. But there is doubt about when that recovery is likely to begin.

Any forecast contains a combination of uncertainties about the timing of when a recovery will begin and a feeling or projection about the rate of growth. So the critical uncertainty of all this is the precise timing of the recovery date.

Representative REUSS. Sure, assuming that that 3 percent current honest hunch is right—and I note that in September you felt with respect to their earlier composite that it didn't seem unreasonable to believe that the actual GNP growth would be in that same range, and I'm quoting you—assuming that it works out at 3 percent growth for 1983, what rate of unemployment does this imply for December of 1983, at year end?

Mr. FELDSTEIN. I really can't give you a precise number on that.

Representative REUSS. There is a correlation.

Mr. FELDSTEIN. There is definitely a correlation. I'll give you a more qualitative statement about what it implies.

Representative REUSS. If you can't give one off the cuff, would you supply it for the record? Because isn't this just a matter of arithmetic?

Mr. FELDSTEIN. Well, it's arithmetic only on the hypothetical assumption that nothing else happens to affect the unemployment rate.

Representative REUSS. Exactly.

Mr. FELDSTEIN. But so many things can happen to affect the unemployment rate.

Representative REUSS. But it would be helpful, assuming no oil shocks, no trouble with the anchovies off the coast of Peru, et cetera. What unemployment rate is yielded? After all, the 3-percent growth rate is based on all other things being equal, too, and so is everything in life.

Mr. FELDSTEIN. But one shouldn't misinterpret that number. I can certainly give you a simple arithmetic workout of what that would mean, but one would have to understand that it depends critically on what happens to productivity, on what happens to these various other factors, including policy changes that might affect unemployment. But I will be happy to supply——

Representative REUSS. You can't do it off the cuff?

Mr. FELDSTEIN. No. All I can say off the cuff is if we move into a recovery and the economy shows that kind of growth year over year, which, of course, means substantially faster growth once the recovery has begun, then we would expect the unemployment rate to be falling.

The one thing that I can say, without pencil and paper and doing more analysis, is that if we have 1983 relative to 1982 up by, say 3 percent, that once the recovery has begun, the economy will be growing substantially faster than 3 percent, and the unemployment rate will be coming down significantly as we move toward the end of the year.

Representative REUSS. We await with interest your arithmetical

workout. Meanwhile I have one more question, not with respect to guessing future unemployment but with respect to the actual rate as it develops. You have testified that the administration has made no further recommendations about measures to relieve the unemployment crisis. That is, you think a recovery will occur by itself; is that not so?

Mr. FELDSTEIN. That isn't what I testified, no.

Representative REUSS. Well, do you have some recommendations as to combating unemployment?

Mr. FELDSTEIN. The administration is now considering several possible actions which would help to reduce the unemployment rate.

Representative REUSS. But you aren't prepared to put them on the table this morning?

Mr. FELDSTEIN. It's not for me to do. The President hasn't made any decisions in this area so we will have to wait.

Representative REUSS. If, in fact, there are no further measures taken to lessen unemployment, how much future unemployment would it take to change your view, that is to bring it to the point where you would believe that meaningful action of a direct nature must be taken against unemployment. Suppose, for instance, the current 10.8-percent level of unemployment persists through next February, 2 months from now. Would you change your mind?

Mr. FELDSTEIN. I really have to come back to the question that you raised before about what the unemployment rate is likely to be in the future. I'd have to look at the circumstances that were associated with it.

Representative REUSS. Well, at a certain point, though, the present and the future meld into one ghastly reality and policy must be made. Suppose we still have 10.8-percent unemployment in March 1983? Would you change your mind?

Mr. FELDSTEIN. I think we should continually look at the unemployment rate, but not just the unemployment rate. If we see that production is rising, if we see that employment is rising, if we see that sales are increasing, we know then that we are in a recovery. Since unemployment begins to decline after a recovery begins, even if the unemployment rate is high, looking at the unemployment rate alone would not be a good indicator of what kind of policy would be appropriate at the moment. So I really don't want to——

Representative REUSS. I'm not asking you to look at the unemployment rate alone, and I'm sure you will not, but suppose unemployment continues at 10.8 percent or worse through April and May and June and July and August and September and October and November and December. At what point will you change your mind and agree that meaningful, forthright, direct action must be taken to diminish the tragedy of unemployment?

Mr. FELDSTEIN. I really can't say at what point I would make a recommendation of different kinds of action, but I can say that I would be very distressed if that happened. I don't expect that to happen. I expect that we will be continuing to look at unemployment and other indicators. And as I said a few minutes ago, given the early indications that the economy is bottoming out, that housing and consumer durables are showing improvements, that interest rates are down, and real money growth is up, I think now the conditions are such that it would be inappropriate to change course.

Representative REUSS. Well, I'm sorry I failed to get you to tell us how long the present 10.8-percent unemployment rate has to persist before there could be a change in policy, but I admire the forthrightness of your answer.

Senator Jepsen.

Senator JEPSEN. Thank you, Mr. Chairman.

Mr. Feldstein, if we could for a minute, I'd like to work up a list of economic indicators. Aren't there basic economic indicators, signposts, more or less, that economists and others in the financial world look at when they take the temperature of the economy and talk about it, and are there less than 10?

Mr. FELDSTEIN. I'm not quite sure what you have in mind, but there are the so-called leading indicators. There are coincident indicators. But if we get away from that formal structure, there are a handful of key things that one would look at in trying to see where the economy is going.

Senator JEPSEN. Is the savings rate, the economy of our people, an important economic indicator?

Mr. FELDSTEIN. Well, the savings rate is very critical for our long-term health and our ability to accumulate capital.

Senator JEPSEN. And in the last 20 months, what has happened to the savings rate in this country?

Mr. FELDSTEIN. I think the personal savings rate has shown an increase and recovery over that period.

Senator JEPSEN. It has nearly doubled. Isn't that a healthy sign?

Mr. FELDSTEIN. I'm not sure what the figure is, but I think that——

Senator JEPSEN. I can tell you it's nearly doubled from what it was about 20 months ago. Now, the interest rates—is that another indicator, economic signpost?

Mr. FELDSTEIN. Yes.

Senator JEPSEN. What has happened to the interest rates in the last 20 months?

Mr. FELDSTEIN. Interest rates, as you know, have come down very substantially, no matter how one measures them. Long-term rates, short-term rates, prime rates, money-market rates—they are all down very significantly, and that provides a thrust for all kinds of interest-sensitive spending: housing, business plant, and equipment.

Senator JEPSEN. And the rate of inflation, is that another signpost?

Mr. FELDSTEIN. I think the rate of inflation is a critical measure of our economic health. Looking back 20 months ago, it was identified widely as public enemy No. 1. I think people frankly were frightened that inflation was out of control in an economy that in the early 1960's had been accustomed to virtual price stability, we found ourselves moving up close to double-digit inflation in the 1970's, and into double-digits in 1979 and 1980, and I think people frankly were frightened. That inflation rate has come down from 12 to 13 percent in 1979 and 1980 to less than 5 percent this year whether one measures it by the CPI or GNP deflator.

Senator JEPSEN. Do you have, just on the tip of your tongue, the amount that the decrease in inflation would translate to by way of purchasing power of an average income person in the country?

Mr. FELDSTEIN. Well, if you take a family with about $20,000 of income—it's a bit below the median-income family but makes it easier

to do arithmetic in my head—and if their income didn't rise at all while inflation dropped from 12 percent to 5 percent, there would be a 7-percent increase in their real income, or about $1,400.

Senator JEPSEN. Productivity or its rate of growth, is that an economic signpost?

Mr. FELDSTEIN. It's a very important thing. Productivity really is the stuff of which real income growth, a rising standard of living, is ultimately made.

Senator JEPSEN. In the last 20 months has that remained static? Has it decreased? Has it increased?

Mr. FELDSTEIN. It finally turned around and started up. We have had productivity declines for the last 3 years, but in this year productivity has started up, and I think in the most recent quarter, the third quarter of this year, productivity rose very sharply, more than 4 percent.

Senator JEPSEN. Do you recall what it was 20 months ago?

Mr. FELDSTEIN. I don't recall. I would say that productivity probably was declining at that time. If productivity declines then ultimately our standard of living is declining. So turning that around is a critical change.

Senator JEPSEN. I have listed the savings rate, interest rates, rate of inflation, and productivity; what other basic signposts measure the health of the economy?

Mr. FELDSTEIN. Well, looking to the short run, the key thing I would use as kind of a general summary is what's happening to the leading indicators which bring together financial variables and other measures of our economic health and those I would say that they are turning and heading up.

Senator JEPSEN. I have just been handed a note saying that productivity has moved from minus 1 in the first quarter to a plus 4.2, quite a dramatic change. In the second quarter of 1981, it was zero. Well, of course, what I'm obviously getting at is whatever gets your attention is going to get ours. We have had some help in focusing attention on a very tragic thing which is, of course, unemployment. I can't think of anything more tragic than someone who really wants to work in this great country of ours but is unable to find a job and is unemployed. Almost all of the basic signposts of economic health in the last 20 months have turned around and are headed in the right direction. That's a very general statement, but would you agree with that, except that one, and that's unemployment?

Mr. FELDSTEIN. I think that's a critical one, obviously, but I believe that it is on the road to repair, that it is going to be improved over time.

Senator JEPSEN. How many people are employed today?

Mr. FELDSTEIN. About 99 million.

Senator JEPSEN. And how does that compare to whatever the maximum number of people we have had employed?

Mr. FELDSTEIN. A little more than 100 million. It's about 1 million off from the peak.

Senator JEPSEN. So we're 1 million off of the record?

Mr. FELDSTEIN. About 1 percent of the labor force down from where we were at the peak.

Senator JEPSEN. This is my last question, Mr. Chairman: If the economic signposts, as they are now, are plainly heading up, is it reasonable to assume, some time hopefully in the near future, that the unemployment rate should turn around and head downward? In fact, with all of the signposts that are in place, one might ask—and everybody is asking—why isn't our economy moving? Why is it sort of flat? And you get right back to all of the knowledgeable people that I have had a chance to exchange ideas with on this matter, and they say that it's the psychology, or the lack of confidence. Would you comment on this area of lack of confidence as a general term? Is it lack of confidence in Government? Is it lack of confidence in the Federal Reserve Board? Is it a lack of confidence in Reaganomics? Is it a lack of confidence in the bureaucracy or Wall Street? Would you comment on that?

Mr. FELDSTEIN. Sure. Let me comment first on the part of your question about unemployment. I think it is true that as the economy recovers unemployment will come down and I think it is reasonable, given all the evidence that we see, to conclude that 1983 will have a higher level of real income. We will be in a period of recovery and, therefore, the unemployment rate will be falling.

Well, what about the psychology? I think it's important to distinguish the psychology of the individual consumer from the psychology of the financial community. Now the individual consumer may be reluctant to spend because the unemployment rate remains high, but that has been a characteristic of this stage of every business cycle.

Spending on things like housing has picked up, as has automobile sales. That shows that consumers have a growing confidence. Indeed, figures that were released yesterday by the conference board in their survey of consumer confidence showed that consumer confidence had moved up from the month before. So-called buying intentions, questions asked about whether this is a good time to buy and whether the consumer is planning to buy, also have shown an increase in the most recent survey relative to previous months. I think that shows that consumer psychology is beginning to move in a more expansionary direction.

Financial markets, and the business community, and the industrial part of our economy, I think, remain quite nervous about long-term interest rates, long-term inflation, and long-term Government borrowing. I think the continued fear of large deficits in future years puts a cloud over the current recovery. The fear that those deficits will, at a minimum, keep real interest rates high and make investment in plant and equipment unattractive for a long period of time, depressed activity today, and depresses investment in plant and equipment today. This not only slows the recovery but also denies our work force of the plant and equipment that they need for greater productivity in the future.

In addition, the fear that we will continue to have deficits in the future, worries many people in the financial community and the business community that such deficits will be the source of inflationary policies in future years. The pressure of large deficits may well lead to monetary policies different from the kinds of monetary policies we have now, creating inflation. They are afraid to lend except at quite high interest rates, and that, too, puts a damper on our current re-

covery. I think if we could get those long-term deficits clearly in hand—the outcome of the budget process this year could be a strong signal that deficits are coming down in the outyears—that would do a lot to change the expectations, the psychology to help our recovery.

Senator JEPSEN. I thank you, Mr. Chairman.

Representative REUSS. Thank you, Senator Jepsen.

Representative Mitchell.

Representative MITCHELL. Mr. Feldstein, I have four or five questions to which I would like for you to respond as succinctly as possible.

I think we are operating under a time constraint. The idea of putting a tax on unemployment compensation benefits was surfaced by someone in the administration. Do you embrace this monstrous idea?

Mr. FELDSTEIN. The President has absolutely rejected the idea so it's not an idea in current discussion. I do not embrace the idea.

Representative MITCHELL. You do not. That is good.

Now someone else of sagacity and wisdom has surfaced the idea of perhaps taxing health benefits, an equally venal and monstrous idea. What is your position on that?

Mr. FELDSTEIN. There is no administration position on it.

Representative MITCHELL. What is yours?

Mr. FELDSTEIN. My thoughts about that I'll reserve for our internal discussions.

Representative MITCHELL. The President proposed in his budget for 1983, after cutting summer youth jobs severely in 1982, the complete elimination of all summer youth jobs. Does it please your fancy to have the summer youth jobs program eliminated.

Mr. FELDSTEIN. I don't know what the facts are on that.

Representative MITCHELL. Well, I do.

Mr. FELDSTEIN. What I understood to be true is that we now have a targeted jobs tax credit that's actually on the books.

Representative MITCHELL. The targeted jobs tax credit has been on the books for quite some time.

Mr. FELDSTEIN. No, a new one.

Representative MITCHELL. Oh, you have a new one?

Mr. FELDSTEIN. We all have it. I think it's been legislated. I think it's on the books. I think it provides an 85-percent tax credit for the employer of eligible young people, which in effect says they can hire young people at 50 cents an hour.

Representative MITCHELL. I'm aware of the tax credit, but summer youth jobs are to be eliminated. What is your position on that?

Mr. FELDSTEIN. I don't know what the program is, but it seems to me that the targeted jobs tax credit is an open-ended opportunity for employers to hire young people at virtually no cost, is a summer job program.

Representative MITCHELL. We have had a targeted tax credit for a long period of time. You've some variation of it. It simply hasn't worked.

Mr. FELDSTEIN. This is a very big variation. It's an 85-percent tax credit.

Representative MITCHELL. It was a fairly generous one before, but given the individual vicissitudes of the economy right now I'm not at all sure 1985 is going to be much of an incentive either. But you're

not going to answer the question about the elimination of summer youth jobs?

Mr. FELDSTEIN. I can't really answer without knowing more than I do now.

Representative MITCHELL. Now you and I both recognize that M_1 is a very faulty indicator with reference to the economy but we have to live with it. It's my understanding that the Federal Reserve has increased the supply of M_1 so if it is annualized it is about 15 percent which is a rather phenomenal rate of growth. It seems to me that there are two problems. One, if you continue to let it go up, you fan the fires of inflation. Two, if the Feds follow their historic policy at some point they're going to abruptly reduce the money supply and then, of course, that would cause more stagnation in the economy. Do you know which way the Fed might go?

Mr. FELDSTEIN. I'm not concerned about the M_1 growth. I'll explain why.

Representative MITCHELL. If you will forgive me, that's why I pointed out that we both recognize that this is not a very good indicator. But let's just work with that because we do use it.

Mr. FELDSTEIN. I don't think the Fed will continue to use M_1 as a significant indicator of policy. I think that the Fed, unless conditions change in the future, will place much more emphasis on M_2. M_2 has grown this year about 9.5 percent, virtually the same growth rate that it had last year. I think the increase in M_1 in the last 6 months reflects a combination of two kinds of structural changes.

One, the ending of some of the NOW accounts; and

Two, the movement along the demand curve for money associated with the fall in nominal interest rates which is a natural consequence of declining inflation.

So I'm not disturbed at all and I doubt that the Fed will be disturbed at all by the fall in M_1 velocity at a time when M_2 velocity is remaining quite stable. Let me be more precise. The M_2 growth path has not changed at all relative to the year before. Moreover, a further reason for thinking the Fed will not do what you and I would both agree would be the wrong thing, overreacting to this recent increase in M_1, is the change that's coming about December 14.

Representative MITCHELL. If it does, it will fly in the face of its history because in the last 20 or 30 years that's exactly what the Fed has done.

The large banks, in my opinion, have acted recklessly in making international loans and they are beginning to hurt a little bit. There are huge loans to Mexico and so forth. There is a possibility that these nations, which are caught in a worldwide recession, might threaten to default on the repayment of these loans. What would you recommend if that happens? Would you rush in to save the big banks with some kind of guarantee or would you let them be wheeled onto the guillotine and their heads chopped off?

Mr. FELDSTEIN. I don't think there's much prospect of the Mexicans, Brazilians, the Argentines, and other countries defaulting in that way. I think those countries know that they are dependent on credit for their very ability to import and export the things they need to sustain their economies. I think it's critical that whatever happens the current depositors who are insured by the FDIC are fully protected in

the outcome. But I really don't think that the prospect of outright default is a significant one.

Representative MITCHELL. I think there is a big danger of all of these countries experiencing extreme economic problems. I don't think they want to default, but I would be curious as to whether or not you would be Sir Galahad in the event of a default.

Mr. FELDSTEIN. I think the banks are independently and voluntarily working with them to try to provide conditions in which they can make continuing payments on their interest, and roll forward their principal obligations, and working with some of the smaller banks and others who are not accustomed to these problems.

Representative MITCHELL. If I may, I have just one last question for this round. I was shocked when you indicated that some improvements in the retail industry and wholesale industry caused you to be rather optimistic about the timing of the recovery. When, as a matter of fact, over the last 5 months in the retail industry, 150,000 people have lost their jobs, and over the last 5 months in the wholesale industry, 60,000 people have lost their jobs.

Now based on that, I'm curious as to why you point to these two categories as being indicative of a recovery right around the corner—not right around the corner, but approaching recovery.

Mr. FELDSTEIN. I spoke just of retail rather than wholesale and I was referring to the very recent sales rather than the employment picture in that industry over the past months. I agree with you that those industries, like so many other industries, have seen declining employment over the last several months.

Representative MITCHELL. Thank you. You're sure you don't want to answer the question about summer youth jobs at present?

Mr. FELDSTEIN. I believe that——

Representative MITCHELL. No; you said that you didn't want to answer.

Mr. FELDSTEIN. I believe the 85-percent tax credit for disadvantaged youth is a very sound approach, a very generous approach to providing an opportunity for them to work. The one thing I would hope that you and others could do would be to help people out there, prospective employers and prospective employee groups, know that it exists so they take advantage of it.

Representative MITCHELL. My answer, Mr. Feldstein, is it obviously has not worked in the past and it is not going to work this summer.

Mr. FELDSTEIN. It is a different program at 85 percent.

Representative MITCHELL. But the mentality hasn't changed and the economic situation of many businesses have not changed.

Thank you, Mr. Chairman.

Representative REUSS. Representative Wylie.

Representative WYLIE. Thank you very much, Mr. Chairman, and may I say welcome, Mr. Feldstein, and congratulations on your confirmation.

Mr. FELDSTEIN. Thank you.

Representative WYLIE. I was reading an article in Business Week last night which created a substantial amount of interest and I think the Chairman of the Federal Reserve might like to read also. It also generated some questions may I say.

On page 92 of the article, it says, "Martin Feldstein, Chairman of the Council of Economic Advisers, believes that it will take 5 or 6 years before unemployment declines to 6 or 7 percent from its present level of 10.4 percent."

We all hope and pray that unemployment will get below the 6-percent level long before that, maybe by March 1, 1984. Are you saying that there isn't anything that we can do to get unemployment below 7 percent before 5 or 6 years?

Mr. FELDSTEIN. That statement which I also made this morning in my testimony refers to what will happen to the unemployment rate if there are no changes in the structural component of unemployment. I think that the effects of structural policies would be to further reduce not only the ultimate level of unemployment but also the speed with which unemployment might decline along the way.

Representative WYLIE. Senator Jepsen, by making a list here a little while ago, indicated there are some bad signs—of course, unemployment being the worst of the bad signs—but there are also some good signs in our economic situation. The stock market is at a near record high level, which indicates some optimism. Interest rates are down. Hours of work in manufacturing are up slightly and this has been alluded to before but I wanted to get back into it on my own.

In light of these cross currents, is the economy improving fast enough or should we in Congress try to do more? You mentioned that we have drawn up the user fee bill for highway construction, the job training bill which I supported, and the export trading bill which I also helped with. Is there anything more that we can do and, as I ask you that question, let me add that in this article it also says that "mired in the deep recession, the whole world is waiting for a recovery in the U.S. economy and that means it is waiting for Volcker to lower interest rates and to provide business and consumer spending."

Would you answer vis-a-vis that statement? Also, considering the fact that we have taken some steps, do we need to take more?

Mr. FELDSTEIN. I think there is a policy in place. As I indicated to the chairman, interest rates have been declining, are declining. Real money supply is growing because the inflation rate is going down and the M_2 growth rate has been maintained. We have a tax cut in place for 1983.

One critical thing that I think Congress can do to help move the recovery, to help bring down long-term interest rates, is to deal with the deficits in 1985 and 1986 and beyond, if the budget comes forward, in a way that is convincing to investors in this country and around the world that the United States is not going to be in the position of borrowing vast sums of money to finance the Government deficit in future years. We will see a healthier recovery and we will see interest rates coming down faster.

Other than that, though, Congress should not try to do more and indeed it would be counterproductive if they did try.

Representative WYLIE. So Congress must deal with the deficits in a way which will be encouraging to investors around the world. Economists seem to increasingly think that we may be facing a structural deficit of well over $100 billion a year for the next several years. If that happens, interest rates are not going to come down. Is that a fair statement?

Mr. FELDSTEIN. Real interest rates would not come down. More precisely, one reason why interest rates are so high now is that there continue to be expectations of high inflation in the future, and it's very hard to know what will move those inflation expectations lower. Two things are working on them simultaneously. The experience of low inflation—the kind of experience we've had this year, and that I expect we will go on having next year—will continue to push down interest rates. But the large deficits, if they're not brought under control, will frighten participants in financial markets and will tend to keep inflation expectations high and therefore interest rates high.

I frankly don't know how to balance those two. I don't know whether the size of the deficit or the inflation experience will be the dominant factor. I suspect, though, that the financial community is anticipating that Congress will do things to bring down the deficit. Current interest rates reflect an expectation of fiscal progress. If that falls through, if Congress and the administration cannot agree upon a fiscal program that brings down the outyear deficits, it will push up the interest rates that we will have in the future.

Representative WYLIE. So what you're saying is that Congress needs to do more, that we can't just lay it all on the Chairman of the Federal Reserve Board and say he's the——

Mr. FELDSTEIN. I think the Chairman of the Federal Reserve Board and the Federal Reserve Board as a whole is doing a very good job. I think the critical problem, the single most important problem, the missing piece in the whole process, is bringing down those outyear deficits.

Representative WYLIE. And it is your opinion that there is a way that the Congress can bring the deficits down below $100 billion over the next several years?

Mr. FELDSTEIN. I believe Congress can bring the deficits down.

Representative WYLIE. Thank you. Also in this article it says the decline in buying by developing countries which normally account for 40 percent of the total U.S. exports is a major reason that trade deficits this year will be $40 billion. That deficit in turn is one reason why the current recession is longer and deeper than had been expected, and it goes on to say that's one of the reasons we're having record high unemployment.

Do you agree with that?

Mr. FELDSTEIN. Yes. I think that's true when you say longer and deeper than had been expected. I think that most economists have given inadequate attention to the international aspects of the American economy. The international aspects of our economic performance have changed over the years. In particular, we have seen in the past few years a quite different reaction to high interest rates than we had in the past. Those high interest rates by strengthening the dollar a great deal, have had the effect of worsening our trade balance.

I think, again, it ultimately comes to what happens to long-term interest rates and therefore to what happens to the deficit. If the deficit in future years is brought under control, then we'll see loan rates down; that will allow the competitive position of U.S. exports to improve and we will have a sounder, healthier, more balanced recovery.

Representative WYLIE. Chairman Reuss made an interesting point that unemployment is 10.8 percent. If unemployment remains at 10.8

percent for another year will you recommend we do something else, if it remains at 10.8 percent through December, January, February, and so forth?

Mr. FELDSTEIN. I think that is so unlikely that I don't want to guess what I would recommend under those circumstances.

Representative WYLIE. Are we near the peak of unemployment?

Mr. FELDSTEIN. The reason I hesitate to answer is, that depends so much on what you mean by "near" and "peak." What we know from historic experience is that once a recovery begins, it takes a couple months, maybe 3 months, before the unemployment rate begins to come down. There's a very widespread consensus among private forecasters, as well as people within the Government, that 1983 will see a higher level of income than 1982, that there is going to be a recovery. If you put those two together, then I think it's fair to say that we are near the peak in the unemployment rate.

Representative WYLIE. Thank you very much. Thank you, Mr. Chairman.

Representative REUSS. Congressman Hawkins.

Representative HAWKINS. Mr. Feldstein, you announced to Representative Wylie that Congress can bring the deficits down. You didn't indicate how. Would you be a little more specific?

Mr. FELDSTEIN. Well, as you know, this is budget time in the administration and the administration will present next month a budget with very specific suggestions on how to bring it down, but until then I'm afraid I really can't provide any more information.

Representative HAWKINS. But you made the statement. I assume you must have a reason for making that statement.

Mr. FELDSTEIN. Yes.

Representative HAWKINS. On what basis did you make the statement which goes into the record that Congress can bring the deficits down. You don't have any particular basis on which to make the statement, do you?

Mr. FELDSTEIN. I do. I make it on——

Representative HAWKINS. On what basis?

Mr. FELDSTEIN. On the basis of deliberations we're having within the administration. This is budget review time and budget planning time.

Representative HAWKINS. What does that have to do with Congress?

Mr. FELDSTEIN. I thought that Congress legislated and that the administration would propose a budget, but it's not up to the administration—the administration and Congress together have to enact specific changes to bring the budget deficit down.

Representative HAWKINS. Let's go on to something else. You indicated that you haven't forecast a 3-percent growth rate, but somewhere in that neighborhood might take place. Do you believe that that is adequate in order to achieve recovery?

Mr. FELDSTEIN. Well, I believe that is consistent with our having recovery, yes.

Representative HAWKINS. Is it adequate to achieve recovery I think was the question.

Mr. FELDSTEIN. It is adequate to achieve a recovery.

Representative HAWKINS. Even assuming that you're correct, how do you intend to achieve this?

Mr. FELDSTEIN. Why do I think the economy is going to have that kind of recovery?

Representative HAWKINS. Well, instead of forecasting it, do you have any particular plan or program whereby it will be achieved?

Mr. FELDSTEIN. Yes. I think there is an economic program in place. The economic program currently has resulted in lower interest rates than we had before. That has stimulated housing and I think it will stimulate, with housing, a demand for consumer durables. It will stimulate the jobs in those industries. That, in turn, will have effects on other kinds of purchases and from there the economy will be stimulated. I think we have a tax cut which is occurring in July 1983 which will provide additional purchasing power to people in the economy. That will help. We are seeing more real money growth in the economy than we have had in the past 2 years. I think that will contribute significantly to the financial conditions which make a recovery possible. Finally, as I said to Congressman Wylie, I think there's a critical problem of bringing down the deficits not in 1983 but in 1985 and 1986 and beyond in a way that provides clear reassurance to financial markets that we don't have the prospect of high inflation or high real interest rates to dampen future demand.

Representative HAWKINS. Well, I'd like to get the name of your optometrist because apparently your glasses are much clearer than mine. You see the most favorable things in everything that is unfavorable and ignore the things that are unfavorable conveniently. Is it not true that we also have the highest deficit in history which also has been the result of the very programs that you say we'll have in recovery? We obviously have the highest unemployment since the 1930's. The median income of the average individual has dropped. You don't see any of these unfavorable signs on which you would base a prediction and respond to in terms of a positive program.

Mr. FELDSTEIN. No, I don't think so, sir. I said in my statement that the economy is currently weak. I am aware of the things you described. I am concerned that that is the current state of the economy, but I also see the things that I have been pointing out as indicators that the economy will turn up and that's not because of my fine glasses. That's a vision, a view, an opinion, that is shared by, I think, virtually every private forecaster.

Representative HAWKINS. I think you should be a little more careful in saying it's shared. I think we have had some able economists that don't share that view.

Mr. FELDSTEIN. They said in their professional opinion that GNP in 1983 will be lower than 1982?

Representative HAWKINS. They have said worse than that. Mr. Feldstein. I won't get into that, however, but when you say economists share your point of view, I think you have to be a little more specific by saying some economists share that view. There are many economists who don't share that view, that the current policies will effect the recovery. As a matter of fact, they say it's impossible if we continue the current policies. So I think that these broad statements do not serve at all to attacking the problems at all.

You indicated as I understand in talking about our structural unemployment that a public employment program is not needed or probably would not be needed. Is that the current thinking?

Mr. FELDSTEIN. I think it would be counterproductive.

Representative HAWKINS. Why?

Mr. FELDSTEIN. It would enlarge our deficits. It would lead to an expectation that the Congress is not aware of the importance of deficits. I think it's just the wrong way of moving. I think that so many times in the past Congress, as a recession lingered on, has tried to design employment programs only to find that they come into play months, even years later, at a time when the economy is already fully in recovery, putting pressures on labor markets in inappropriate ways.

I think it's really just not the right thing to do.

Representative HAWKINS. Would you mention a specific program that has been put in place that has delayed recovery that has not served its purpose and has not been cost effective?

Mr. FELDSTEIN. Yes, I could get you a specific citation. I remember in the 1974–75 recession that Congress legislated a major program which actually reached its peak spending in about 1976 or 1977 well after the economy had moved into recovery.

Representative HAWKINS. Which program?

Mr. FELDSTEIN. I'll have to get you the specific title. I would be happy to do that.

Representative HAWKINS. I wish you would submit that specific program and give us a finding, the evaluation of it by any agency that evaluated the program, what its results were in terms of placement and what it achieved or did not achieve, because this broad statement is constantly being made by the administration——

Mr. FELDSTEIN. I'll be happy to offer you an example of that.

Representative HAWKINS [continuing]. Without any substantial reason for making the statement. I think you also said something about the current highway program that we're considering in Congress and you supported that. Although you oppose a public employment program, you support that. You support the method of paying for it as well?

Mr. FELDSTEIN. I do.

Representative HAWKINS. You support the regressive tax that is to support it as being productive and job producing?

Mr. FELDSTEIN. I think the user tax is a good way of paying for the road improvement.

Representative HAWKINS. Do you consider it a regressive tax?

Mr. FELDSTEIN. I haven't thought about it in quite those terms.

Representative HAWKINS. Now, Mr. Feldstein, I'm sure you must have thought about it. Do you consider that a regressive tax? Is it or isn't it a regressive tax? You're a noted economist. I know you're an able one. I know that you know whether it is or it isn't.

Mr. FELDSTEIN. If I think of it as a benefit tax rather than a redistributive tax, I don't ask myself that question. I think of it as a user charge for roads. I don't ask myself whether the toll on the Holland Tunnel is regressive or not.

Representative HAWKINS. In connection with youth unemployment, I think you said 40 percent of the unemployed are under 25.

Mr. FELDSTEIN. That's correct.

Representative HAWKINS. Which is half teenagers. Striking out 20 percent in 40 percent, that would still leave 80 percent nonteenagers who are unemployed. Actually, I think you would recognize that the real number of unemployed is not those that are officially counted but there are many others that are not counted—part-time, discouraged, and so forth. So isn't it true that, generally speaking, we recognize that unemployment is the major problem facing the Nation at this time?

Mr. FELDSTEIN. Well, I think it would be a mistake to say we have one problem in 1983 and we will work on that problem to the exclusion of all others, and when we have "solved" that we will move on to the next.

Representative HAWKINS. I would agree with your statement now. Let me rephrase it. When it was inflation, of course, the President said inflation was the No. 1 problem so we've got to attack that and said until we solve that we can't deal with the unemployment. So his thinking was different from what you concluded in your statement there, but let's say it is certainly among the major problems.

Mr. FELDSTEIN. Absolutely.

Representative HAWKINS. It's just as major as any other problem?

Mr. FELDSTEIN. Absolutely.

Representative HAWKINS. As the President said, it is a national tragedy. That is what the President himself said in some foreign country a few days ago. that it is a national tragedy.

Now if it is a national tragedy, can you detail to us specifically what you and the administration propose to do about this national tragedy in terms of specific programs within a reasonable length of time?

Mr. FELDSTEIN. As I said in my statement, this is a problem which is very serious now, and fortunately it is a problem that can be solved by a recovery. There is nothing that we can do in the way of specific little programs to hire some people here or there even if the progams didn't have adverse side effects which I think are very important. No simple little program can deal with the fact that we need to create 15 million additional jobs over the next half dozen years to absorb the currently unemployed and those who are yet to enter the labor force.

Now what I have been saying is that I think we have a program in place which can produce a noninflationary economic recovery that can provide those 15 million jobs over the next 5 or 6 years.

Representative HAWKINS. Well, those programs have been in place for 2 years now.

Mr. FELDSTEIN. No.

Representative HAWKINS. Isn't that true?

Mr. FELDSTEIN. No. I think what is true is that we—2 years ago we saw an economy which was suffering from terrible inflation, with people frightened about inflation getting out of control; 12 and 13 percent inflation back-to-back for 2 years. We have now seen that turned around.

Representative HAWKINS. Seen what turned around? You haven't seen the unemployment turned around.

Mr. FELDSTEIN. The inflation turned around and we are now in a position which is therefore very different from what it was 2 years ago.

Representative HAWKINS. Let's go back. You have not seen unem-

ployment turn around. You have seen it escalate terribly in the 2 years the tax reduction has been in place which is one of the programs. You have seen deregulation take place which is another of the programs and you have seen unemployment escalate despite the monetary policies favored by the administration.

Now what program do you have—what specific program do you have in place to put unemployed people to work? That's really the gist of it.

Mr. FELDSTEIN. We call that program economic recovery. I don't know of any period in history when a sustained accelerating inflation has been brought under control by any means which did not lead to a period of increasing unemployment. But I think it's behind us now. I think if we sustain the economic policies that the administration favors, we are now in a position, as we were not 2 years ago, to have falling unemployment, gradually declining inflation, and an increase in the rate of investment in the economy.

Representative HAWKINS. It seems to me from what you have said that we have been involved in a tradeoff policy in this administration, that to attack inflation you set out to create unemployment, and you're now in the position that you're afraid to do something about unemployment for fear it will reignite inflation. So what we are doing, we are getting back to the discarded, unsuccessful programs that haven't worked in the past and aren't going to work today and that you don't have anything specific to offer to the individual who is unemployed except to say your situation is tragic.

Mr. FELDSTEIN. No, I don't think that's true, sir.

Representative HAWKINS. Well, how would you describe the persons who are unemployed today that you describe as tragic—what would you, as a representative, if you had to go out as some of us do and face those people, and tell them what they can do about their condition today—just what would you say to those people?

Mr. FELDSTEIN. Well, first, let me go back to your statement about choosing to create unemployment.

Representative HAWKINS. Well, that's what you've done.

Mr. FELDSTEIN. I don't accept the view about the tradeoff you referred to.

Representative HAWKINS. The Secretary of the Treasury has said this is the price we pay. Other administration officials have said we've got to make the sacrifice. We've got to suffer some recession. This is the price you pay. They tell you someone obviously pays the price.

Mr. FELDSTEIN. I don't want to comment on my colleagues' statements, but let me repeat what I said a moment ago and then comment on its implications.

What I said a moment ago is I know of no historic instance in which an economy has allowed inflation to get out of hand as we did in this country in the latter part of the 1970's and then brought it back under control, back down to the kind of levels in which people do not have to worry about it, without a period of unemployment.

Now what's the prospect? We could have done that in 1981, in 1982, with the suffering that has been involved, or we could have waited until 1985 and 1986 when the inflation rate might have been 19 and 20 percent. Bringing it under control would have involved even more suffering, more unemployment. I think there is no tradeoff. There's a question of when, not whether. There's a question of whether you have

less or more, and I think the administration has had less unemployment in bringing down inflation than would have occurred if inflation had been allowed to go on getting out of hand.

Representative HAWKINS. My time has run out. May I just cite to you periods in which we've done both where we could attack inflation and unemployment simultaneously, and that is the law today, the Full Employment and Balanced Growth Act, which is a mandate which you completely ignore. From 1961 to 1965, we brought unemployment down below 4 percent and we had inflation but an inflation rate at 2.9 percent.

Mr. FELDSTEIN. The inflation rate in 1962 was zero. There was no inflation to be brought down at that point. There had not been a period of irresponsible inflationary——

Representative HAWKINS. You just made the statement that to bring inflation down there was a period in which you had to bring unemployment up. I'm saying there are periods of time and I just cited one. I don't have time to cite others.

Mr. FELDSTEIN. You did not cite a period in which inflation came down.

Representative HAWKINS. Are you denying that from 1961 to 1965 we didn't bring both inflation and unemployment down?

Mr. FELDSTEIN. Absolutely. Inflation rose over that period of time.

Representative HAWKINS. Rose from what to what?

Mr. FELDSTEIN. It rose from a very low level.

Representative HAWKINS. At what rate was it? What was the highest rate?

Mr. FELDSTEIN. I don't remember, but the point is you were not bringing it down.

Representative HAWKINS. But you make a statement that it did not.

Mr. FELDSTEIN. It was not being brought down.

Representative HAWKINS. It rose after 1965, but was it not true that from 1961 to 1965 that it was below 4 percent?

Mr. FELDSTEIN. I believe that's probably true. It did not come down during that period.

Representative HAWKINS. So you didn't have the trade off.

Mr. FELDSTEIN. It did not come down.

Representative HAWKINS. And you didn't have the theory that you now employ that in order to protect the inflation or stabilize the dollar that you've got to tolerate this high level of unemployment. That is the inescapable conclusion it seems to me from what is happening today.

Representative WYLIE. Mr. Chairman, may I interrupt at this point? I think Mr. Feldstein is referring to the jobs program in the 1974 recession. That was published by the OMB study which was published by the Joint Economic Committee in 1980, that it did not have any impact to speak of until 1976 or early 1977. That was also mentioned in an article in the Wall Street Journal on November 30, 1982, that the public works program was enacted in 1972 to fight recession that had ended in 1970. I just thought that ought to be put in for the record.

Mr. FELDSTEIN. Thank you, Congressman Wylie.

Representative HAWKINS. May the record also be clarified to state I did not state the employment program was a means of increasing the condition merely during a recession. I was stating that an employment program, an employment policy should be in place before a crisis developed and it isn't merely to respond to a crisis, and today we

don't have one in place at all. We have repealed or eliminated every possible program, including a decrease in the Job Corps that would put some of those unemployed youth to work that Mr. Feldstein said should be put to work. My point is that we don't have any.

Representative REUSS. Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Mr. Feldstein, if I understood you correctly, you said in response to the questions put to you by Chairman Reuss, that you did not think any action should be taken now to deal with the employment problem. Is that correct?

Mr. FELDSTEIN. Well, I also said, sir, that the administration is considering a variety of programs which will deal with the long-term or structural component of unemployment. Obviously, I think those are very much worth considering and enacting if the administration selects some of them.

Senator SARBANES. I want to be very clear. The chairman asked you repeatedly at what point you would recommend actions to deal with unemployment and you, in effect, refused to answer. I understood you to say that you thought unemployment was going to start down and therefore there was nothing that needed to be done and we should stay the course. Is that essentially correct?

Mr. FELDSTEIN. Not quite. The distinction I failed to make I think in answering that question was between those things that we should be doing specifically to deal with the cyclical condition that we find ourselves in, where I said I wouldn't do anything now; and those things which are of a more permanent nature and would deal with the structural problem where I agree with Representative Hawkins.

Senator SARBANES. You say we don't need to do anything to deal with the cyclical aspects of the problem because it's your position that we are recovering in that area; is that correct?

Mr. FELDSTEIN. No. It's my position that we have a variety of policies in place that will lead to a recovery, monetary and fiscal policies that will contribute to an upturn, that there's a very wide——

Senator SARBANES. Do you think that is at work now?

Mr. FELDSTEIN. I do.

Senator SARBANES. You do. All right. Now in September of this year, in your confirmation hearing before the Senate Banking Committee, you said then something roughly comparable. You said the economy then seemed ready to recover. At the time you made that statement the unemployment rate was 9.8 percent. The figure reported in the first week of October subsequent to your statement on September 22 was 10.1 percent. The figure reported in the first week of November for unemployment was 10.4 percent. The figure reported in the first week of December was 10.8 percent.

Less than 3 months subsequent to your assertion then that the economy was about to recover, the unemployment rate has gone from 9.8 to 10.8 percent.

Now, in effect, you are telling us the same thing here this morning, as I understand it.

Let me ask you this question. If the unemployment rate in the next 3 months moves in the same way that it moved in the 3 months subsequently to your last assertion that recovery was here and in effect we didn't need to do anything, will you continue to hold that position?

Mr. FELDSTEIN. Let me go back to what you said about my statement then versus now. Of course, I'm disappointed that we haven't seen a recovery in the last few months.

Senator SARBANES. I would hope so. When is disappointment going to translate into action? When are these assertions on your part and on the part of the President and leading figures of the administration—that unemployment is a serious problem, that it causes great distress, that they're really upset and sympathetic to what's happening to the millions of people out of jobs—when is that going to translate into action that will do something?

Mr. FELDSTEIN. I think it would be wrong to try to stimulate the economy excessively at a time when there is very widespread professional agreement that a recovery is about to occur. If I felt that those conditions had changed, then I would, of course, be asking myself and discussing with my colleagues in the administration what ought to be done. But I think we now are in a situation where widespread, virtually unanimous professional opinion is that the economy is about to recover.

Senator SARBANES. If the unemployment rate in the next 3 months were to move as it moved in the three reports subsequent to your statement on the 22d of September, would you say that the premise of the assertion you have just made would be proven faulty and that action had to be taken?

Mr. FELDSTEIN. I really can't answer it and——

Senator SARBANES. In other words, what you're saying is the unemployment rate could go to 11.8 percent and you would still sit in front of the committee and say, "stay the course"?

Mr. FELDSTEIN. I would look at all the evidence. I wouldn't look at a single number as I said to Congressman Reuss. If production were rising in January, employment started up in February, if sales were higher in December and January, wouldn't it be wrong to take action to try to stimulate the economy just because the unemployment rate had lagged for a month or two?

Senator SARBANES. Let's take those indicators you and Senator Jepsen ran through, a kind of series of indicators there. What about industrial production? Is that an important indicator of what's happening to the economy?

Mr. FELDSTEIN. Industrial production is down.

Senator SARBANES. Is it an important indicator?

Mr. FELDSTEIN. It's an important indicator of where the business cycle is.

Senator SARBANES. And what's happened to industrial production?

Mr. FELDSTEIN. Industrial production has come down significantly as it always does during recession.

Senator SARBANES. So that's not turning up, is it?

Mr. FELDSTEIN. Not yet, but it will if experience repeats itself. It will go up more sharply than GNP as a whole when the recovery begins.

Senator SARBANES. What about the leading indicators? Are they up? They're up slightly; is that right?

Mr. FELDSTEIN. They've been up for 6 out of the last 7 months.

Senator SARBANES. And to what extent are they up because of the stock market price component of the leading indicators?

Mr. FELDSTEIN. It's 1 of the 11 components that currently is figured into the leading indicators—housing starts——

Senator SARBANES. Isn't it the one that is most responsible for the turnup in the leading indicators?

Mr. FELDSTEIN. I can't actually tell you the weights on the different ones, but if you look at the last one, I think that roughly half of them were positive and half of them were negative.

Senator SARBANES. Well, Mr. Feldstein, you're an intelligent economist and I think the members of this committee are intelligent Members of the Congress. Isn't it correct that of the factors included in the leading indicators index the increase in stock market prices is the one that has most contributed to the turnup in the indicators?

Mr. FELDSTEIN. I don't know the details to answer that question. I know that about half of the indicators were up and about half of them were not. But on balance, the leading indicators were up. I don't know how much weight should be put on the specific components within it.

Senator SARBANES. On the question of staying the course, in your confirmation hearing Senator Riegle questioned you at length on your own personal situation. I think that was relevant to the extent of the question of sensitivity to the burdens or sacrifices that other people are experiencing. The American people would understand an economic policy that called for sacrifice from the top to the bottom, if it was part of a policy which, when they looked at it, seemed to make sense in terms of improving the economy. But what sacrifice are the wealthy, those at the top of the income scale, making under the economic policy of the Reagan administration? Isn't it a fact that they're reaping significant benefits?

Mr. FELDSTEIN. Well, I think we both recognize two things. One, in the long run, everybody can gain from a healthy, growing economy. In the short run, everybody loses from a recession. The unemployed lose, but also those who depend upon corporate profits lose.

If you look at what's happened to income over the past year or two, I suspect that you'd find that profits have fallen much more sharply than income as a whole, that wage and salary income in real terms has declined a bit over the last year but that profits have declined substantially more.

Senator SARBANES. But the tax benefits of the Reagan program are heavily weighted to the upper end of the income scale.

Now the National Journal study—are you familiar with that study?

Mr. FELDSTEIN. I'm not sure what study you have in mind. I know the Journal.

Senator SARBANES. It's the study that shows that the consequences of the administration's policy are to improve the economic situation of the top fifth of the income scale and to worsen the situation on the other four-fifths of the Nation.

Mr. FELDSTEIN. Let me discuss the tax cut and then more generally about——

Senator SARBANES. Well, what about the study.

Mr. FELDSTEIN. I don't know the study particularly.

Senator SARBANES. I commend it to you.

Mr. FELDSTEIN. What we know is that the tax cut that the Congress enacted was a broad, across-the-board cut. It cut taxes in proportion.

Obviously, those people who don't pay any tax at all don't benefit from a tax cut. So there's no question that an across-the-board tax cut only reduces the taxes of those who pay taxes.

But I think it's really wrong to look at it in terms of moving money from Peter to Paul. I think the real question is what happens over time, whether a program that is designed to provide an environment for investment and growth isn't the right way to help everybody.

Senator SARBANES. How much in goods and services are we losing when unemployment is 10.8 percent as opposed to, say, 6 percent?

Mr. FELDSTEIN. I don't have a quantification of that. We are losing a substantial amount.

Senator SARBANES. $250 billion?

Mr. FELDSTEIN. I don't know what the number is. We are losing a substantial amount, but the key thing is, as I said to Congressman Hawkins——

Senator SARBANES. If you don't start giving us some answers on these numbers, we may start to wonder about all the plaudits you've been receiving for your talents. That's not a hard figure. Economists talk about it all the time.

Mr. FELDSTEIN. Let me say that we are saving money by having a smaller recession.

Senator SARBANES. If we were at 6-percent unemployment, how much larger would the total of goods and services available to the Nation be? Does $250 billion strike you as an unreasonable estimate of that figure?

Mr. FELDSTEIN. I hesitate to answer the question because I don't want to answer it out of context. I think what you're suggesting is that there was a choice, that one could have avoided this and everything else would have been all right.

Senator SARBANES. No, no. I want you to answer that question. Then if you want to qualify it, go ahead and do it; but I want to get some sense of the dimension of the gap of what we're losing in goods and services the Nation would have to strengthen it if we were at 6 percent—with unemployment at 10.8 percent as compared to 6 percent. If I can't get you to be sensitive to the tragedy of the individual and families confronted with unemployment, then perhaps you will be sensitive to the loss to the Nation resulting from such significant unemployment, from the fact that capacity utilization of plant and equipment is now below 70 percent—another indicator incidentally that has been moving downward—to the social loss to the Nation of these foregone goods and services.

Mr. FELDSTEIN. I am sensitive to both, sir.

Senator SARBANES. It's not reflected in the policy recommendations as I see them.

Let me ask you this question. Is Mr. Kudlow an associate of yours in the executive branch of the Government?

Mr. FELDSTEIN. He is a member of the Office of Management and Budget.

Senator SARBANES. Well, is he an associate of yours?

Mr. FELDSTEIN. He's a member of the administration.

Senator SARBANES. Thank you. In a statement yesterday, he indicated the policies that the administration now has in place, if carried out on a trend line to the end of 1988, even assuming a 6-percent unem-

ployment rate at that time, would still leave us with a deficit of $150 billion. Do you think that's an accurate projection?

Mr. FELDSTEIN. That kind of a projection is based on the assumption that Congress enacts no changes in existing programs. That's not what the administration plans to do. I haven't seen Mr. Kudlow's specific statement, but I'm sure that is not the intention of the administration's program.

Senator SARBANES. Before we discuss the changes, is it your understanding that that projection is accurate?

Mr. FELDSTEIN. If there were no changes in economic programs, if the administration proposed no budget changes other than a continuation of last year's budget, which it will not do, then we would have deficits on that order of magnitude. But that, as I'm sure Mr. Kudlow must have pointed out to his audience, is not where the administration is going. The administration will seek ways to reduce the deficit in future years.

Senator SARBANES. Would you say that a deficit of that magnitude, at 6-percent unemployment, would not be a good economic policy?

Mr. FELDSTEIN. Absolutely.

Senator SARBANES. What do you think is the connection between the deficits and inflation?

Mr. FELDSTEIN. The connection is an indirect one.

Senator SARBANES. Is it a close one? Is there some real cause and effect there?

Mr. FELDSTEIN. There's cause and effect only insofar as budget deficits lead to further policy changes. That is, it is not through the market itself and through natural forces that large budget deficits lead to inflation. What I think might be widely feared is that if we have substantial budget deficits stretching out into the future, there would be growing pressure on the Federal Reserve to increase the money supply more rapidly and that, in turn, would lead to higher inflation.

The budget deficits themselves would do substantial harm but that harm would not come in the form of inflation.

Senator SARBANES. Do you consider that statement a change in your position from the statement you made before the American Paper Institute in October 1981, and I quote, "But the causal link between deficits and inflation is really very weak"?

Mr. FELDSTEIN. No, not at all. As I said, the link is not a market link. The link is a link that has to work through the influence of deficits on monetary policy. That's what I could imagine people fearing. Indeed, that's what I could imagine happening if budget deficits are allowed to persist. They would lead to the temptation to make them go away by hidden increases in taxation, by inflating the economy, pushing people into higher tax brackets. This, of course, would require eliminating the indexing provision which is now in the law to protect them from that.

Senator SARBANES. You made the point that you don't accept these trend projections. You think something should be done about them. What is it you think should be done?

Mr. FELDSTEIN. Well, I can't answer that very specifically because the administration is currently in the process of formulating its budget, but I think that the administration will present a budget to

Congress which indicates ways of bringing down the deficit to substantially lower numbers over time.

Senator SARBANES. In general terms, what are those ways?

Mr. FELDSTEIN. I really don't think it's appropriate, Senator, for me to speak about the budget provisions before the President has made them.

Senator SARBANES. But you're talking about cuts in spending?

Mr. FELDSTEIN. I'm just not going to answer specific questions about how the budget should be changed until the President has made his decisions.

Senator SARBANES. If you increased spending, would that contribute to improving this situation?

Mr. FELDSTEIN. Increases in spending would not.

Senator SARBANES. Would decreases in spending improve the trend lines?

Mr. FELDSTEIN. The deficit is the difference between spending and taxes. If you decrease spending or increase taxes, you would reduce the deficit.

Senator SARBANES. So, you're saying, as I understand it, that if you want to address this trend line. You either decrease spending or increase taxes; is that correct?

Mr. FELDSTEIN. Or both.

Senator SARBANES. Now as between those two, on what basis does one make the judgment?

Mr. FELDSTEIN. Well, you look at each spending program and you say what are its effects on the people that are affected by it and what is the effect on the economy. You look at each tax, the potential tax revenue, and say what are its impacts on the individuals that are affected, on the economy as a whole, and in both cases you look at the revenue impact. Then you have to decide.

Senator SARBANES. Now what's your view on the extent to which military spending should be subject to scrutiny?

Mr. FELDSTEIN. I believe that military spending, like every other part of the budget, should be carefully examined.

Senator SARBANES. And do you think cuts are needed in that area?

Mr. FELDSTEIN. I won't comment on any of the specific areas of the budget, but I do think that every part of it should be examined very carefully and I can say to you that I know that every part is being examined very carefully by the people in OMB and by the people in the individual agencies.

Senator SARBANES. Taking this projected trend line of a $150 billion gap at the 6-percent unemployment figure in 1988, do you think that that gap can be closed on the spending side alone or would it also require actions on the tax side?

Mr. FELDSTEIN. Well, $150 billion in 1988 would be about 3 percent of GNP. We now spend about 24 percent of GNP.

Senator SARBANES. Twenty-four percent of GNP is spent by the Government?

Mr. FELDSTEIN. The Federal Government. Government expenditures are about 23 or 24 percent of GNP.

Senator SARBANES. Isn't it the case that that figure goes up when the economy goes into recession if GNP doesn't grow?

Mr. FELDSTEIN. Yes, and my figure may——

Senator SARBANES. If you look back over time, wouldn't you generally find that the figure was lower in terms of the Federal share of the GNP at times when the economy was really moving very vigorously and the GNP expanding significantly?

Mr. FELDSTEIN. I thought you said Mr. Kudlow's figure referred to the size of the deficit at full employment.

Senator SARBANES. Well, at 6 percent.

Mr. FELDSTEIN. Six percent.

Senator SARBANES. I don't want to engage now in a discussion of what constitutes the full employment rate.

Mr. FELDSTEIN. But at 6 percent—the cyclical aspect is not there. He's judging from the newspaper accounts that referred to structural deficits at the time.

Senator SARBANES. On defense spending again, is it your view that an appropriate level of defense spending has been set or that it needs to be examined?

Mr. FELDSTEIN. I repeat that I think every part of the budget deserves careful examination.

Senator SARBANES. Murray Weidenbaum, in the first press conference he had after he left office, went out and said that we should really have taken a closer look at the defense budget. The fact is that the increases in the defense budget outbalanced the cuts in the domestic programs, as difficult as many of them were, and have inflicted harm on many people. You know, it's regrettable that he feels he can only give that advice after he's left office.

Are you starting down the same path on your very first day following confirmation?

Mr. FELDSTEIN. I'm not sure that I even understand the question. As I said before, the defense budget is being subjected to careful scrutiny within the administration. The question of what is an appropriate size has to be determined by looking at individual programs, and their impact, and their costs. This has to be done in each of the other areas of the government as well.

Senator SARBANES. You're very strong on capital formation; is that correct?

Mr. FELDSTEIN. That is correct.

Senator SARBANES. And I think some emphasis in that area is important. Do you believe that there's such a thing as capital formation by public sector expenditures?

Mr. FELDSTEIN. Absolutely.

Senator SARBANES. How does that relate to your view on reducing the share of the GNP spent through the public sector?

Mr. FELDSTEIN. Well, let me give you an example of public sector capital formation that could not be done by the private sector and that clearly contributes to our overall economic performance—the highways and bridges program. Clearly, that's public sector capital and clearly it contributes to our overall economic well-being. So I think there is a role for public sector capital formation. Obviously, most of our productive capital stock has to be in the private sector, but I think there's clearly a role for public sector capital formation.

Senator SARBANES. How do you address the problem that money will go into the casinos and won't go, or isn't going, to improve our railroad system or our ports, and so forth?

Mr. FELDSTEIN. I don't specifically want to talk about casinos, but it's true that the private sector puts its dollars where people want them. If people want to buy video games, the manufacturers will build video games. If people want to buy clothing, the manufacturers will make clothing. I think that's the basic starting point of a market economy. We believe people should have the choice of how they spend their money and we shouldn't interfere with firms that want to provide the facilities for making those things.

Senator SARBANES. Then how do you get the public sector investment that you think is important if you don't interfere with those choices to some extent if through no other way than through the tax system?

Mr. FELDSTEIN. Obviously, we have taxes. I'm not suggesting we have an economy with no taxes in it. We have about a fifth of our GNP going in taxes and the administration has just proposed and the Congress is currently considering, as you know, a program of public investment in our roads and highways.

Senator SARBANES. On that point, in response to Congressman Hawkins on whether the gasoline tax was regressive, you said, as I understand it, that it really depended on whether you considered it in benefit terms or distribution terms. Then you went on to consider it in benefit terms. If you consider it in distribution terms, is it regressive?

Mr. FELDSTEIN. It's a tax—I don't actually know the answer to the question. What you're asking me is whether the number we have been told, $30 a year on average for a typical driver, rises more or less than proportionately with income. I frankly don't know the answer to that because I don't know enough about the driving habits of the American public. I suppose low-income people are much less likely to own a car, let alone two or more cars. They are less likely—not to say that none of them do—to take long trips than higher income people. So to that extent, I would think that higher income people are likely to drive more miles and pay more on gasoline and therefore pay more tax than lower income people who use public transportation. From that point of view, if that assumption is correct, it is not a regressive tax. But I would have to check out the details to know the answer.

Senator SARBANES. Mr. Feldstein, you make a distinction between benefit and distribution, and then the answer you went on to give was a reasonable and intelligent response. I find the one you have just given not falling into the same category.

Isn't it true that most of your colleagues in the profession, when asked on the distribution question, would regard the gasoline tax as regressive?

Mr. FELDSTEIN. I don't know what the facts are and I don't know what my colleagues think about that. I don't know what the facts are on who does how much driving and therefore consumes how many gallons of gasoline.

Senator SARBANES. With respect to your reference to the 1979 inflation rate, what part of that was a consequence of the oil shock?

Mr. FELDSTEIN. Economists differ about that. I would say that most economists say a very small part of that was due to the oil shock per se. Canada, which is a net oil exporter, actually saw at least as large an increase in inflation as we did. Germany, which has very little in the

way of oil reserves, didn't have the kind of inflation increase in 1979 that we did. Japan, which has to import all of its oil, took the 1979 shock much better than we did.

So I don't think you can parcel out exactly how much of it is due to oil. But you have to, as a minimum, say oil plus the monetary policies of accommodation that went with that shock were responsible.

Senator SARBANES. I have exceeded my time, but I want to close by bringing you back to the point I was making earlier, and that is the American people are now becoming increasingly traumatized by the prospect of rising unemployment. For the person or family experiencing it, it's completely devastating. The person who loses his job has in effect fallen off the course. There's no course on which that person can stay. The increase in business bankruptcies, home mortgage foreclosures, and farm failures are all indications of people who have been playing according to the rules and in most instances are simply being wiped out through no fault of their own.

I don't think it's sufficient to simply come before us and say that people have to stay this course, especially when it is clear that the economic policies are working to the significant benefit of a small privileged group at the upper end of the income scale while the burdens are being placed upon middle income and working people.

I would hope—although I realize it's probably a vain hope—that you and the administration would address that problem. You're going to be coming back here, I assume, given the close relationship between the Joint Economic Committee and the Council of Economic Advisers, repeatedly. We are very pleased that you are here today and we expect to pursue these problems from month to month, if not week to week, fairly soon. Not knowing the facts or not having a position is not going to be sufficient in responding to the committee, and you're going to be held to account.

What most concerns me about holding you to account is the fact that less than 3 months ago you came before a congressional committee and said the economy seemed about ready to recover; the unemployment rate went over the next 2½ months from 9.8 percent to 10.8 percent, and yet you're repeating that sad litany again this morning. Many people are beginning to ask very seriously not when will the recession end but if it will end, and that's the fundamental question that the administration has to confront in its economic policy.

Thank you, Mr. Chairman.

Representative REUSS. Mr. Feldstein, I have to say that I think what Senator Sarbanes just said represents not just his individual views but the views of every single Democratic member of the Joint Economic Committee and I hope it will be so taken.

Not to be purely negative, however, I do want to express agreement with some of the points you have made. You testified this morning that you oppose the taxation of unemployment compensation as a method of making unemployment less attractive and I agree with your testimony this morning very heartily.

Second, in November you produced a memorandum and recommendation stating that the net result of the highway reconditioning program financed by the 5-cent increase in the gasoline tax would destroy more jobs than it created and thus be a bad bill, and I agree with your recommendation of last month on that.

Third, I agree with what you said this morning that the Federal Reserve in the last few months, in abandoning extreme monetarism and letting the rate of creation of the monetary aggregates be well above its professed target ranges, deserve bouquets rather than brickbats and I heartily agree with that.

On that point of monetary policy and having said what I just said, I direct your attention to the fact that something awful, unless it's stopped, is going to start happening on January 1. The Federal Reserve, pursuant to the statutory mandate, has currently presented to the Congress and to the Nation its intention, starting January 1 and throughout 1983, of reducing the growth rate of the monetary aggregates to much, much less than it has recently been. Specifically, it would reduce the rate of growth of M_1 to something like 4 percent. That's the midrange between 2.5 and 5.5 percent.

It is my view that such a new monetary policy starting 3 weeks from now would be a disaster and that the Federal Reserve should withdraw that intention and instead indicate that it is going to look at all factors—monetary aggregates, total credit aggregates, interest rates and everything else which it has to in order to have a sensible monetary policy.

Do you agree or disagree?

Mr. FELDSTEIN. I think that the Fed in setting its monetary targets should look at—and I believe it does look at—a broad range of economic information. I do not think that the Fed has abandoned its basic position. I think that they have recognized structural reasons why the basic relationship between M_1 and the nominal GNP has changed. Therefore, it is consistent with their basic approach. And I think it would also be appropriate to consider that in looking at next year's targets.

Can I make one other brief comment? That is, you seemed to say that I said previously that the administration's highway bill was not a good bill. I think it is a good bill. I think it is a good bill and I have never said anything to the contrary. I think it is a bill which deals with the problem of highways and bridges and, as the Washington Post said in its editorial yesterday, that's the way the bill should be considered and it's a good bill on that account.

Representative REUSS. You resist the accolade which I retroactively thrust upon you?

Mr. FELDSTEIN. I didn't notice it was an accolade.

Representative REUSS. Well, it was. I said that your November memorandum was a masterly piece of forthrightness and insight. I can't say enough for it. It's a tribute to you.

You use the word "structural" about everything nowadays. It's structural unemployment. It's structural deficits. Now it's structural monetary policy.

Mr. FELDSTEIN. Did I use that word structural in monetary policy?

Representative REUSS. Structural, smuctural. It really does no credit. It's not a tidy, orderly economic term.

Mr. FELDSTEIN. It is, I think.

Representative REUSS. As a tidy, orderly economist, please don't use it before this committee. You didn't quite answer my question, though, which is—should the Federal Reserve promptly repudiate, disavow, and withdraw its announced intention as of January 1, 1983,

of reducing the rate of growth of M_1 to the midpoint of a 2.5–5.5-percent target range?

Mr. FELDSTEIN. I don't think I, as a member of the administration, should comment on the appropriate monetary growth rate of the Fed.

Representative REUSS. You just have this morning. The administration does all the time and this committee welcomes it. You should comment on it. So please comment on it.

Mr. FELDSTEIN. I think I did comment that I think in the past they have been doing a good job. My reading of the evidence is that they have not changed their policy, but I don't want to be in a position of telling the Fed the growth rate of the monetary aggregates that they should be following in the future. I'm perfectly happy to do that when I'm a private citizen again, either before this committee or in other ways, but I think while I am in a position in the administration it's really inappropriate for me to do so.

Representative REUSS. But it's your administration which in its February 18 economic recovery program set forth on page 68 that the Federal Reserve should steadily reduce the rate of growth of the monetary aggregates and thus it is in response to the Reagan administration's tight money policies that the Fed issued its announcement of what it's going to do in 1983. So, you or your administration having caused the problem, don't you want to take this last moment of repentence and tell them to knock it off?

Mr. FELDSTEIN. What I would do without violating a rule I impose on myself is to say that I concur in the Fed's judgment as expressed by Chairman Volcker that the relation between M_1 and nominal GNP has changed for various structural reasons. It's likely to change further because of the December 14 deregulation. Therefore purusing the same monetary policy as they were pursuing before doesn't mean sticking to the same M_1 target that they announced earlier. I think there's no question about that.

Representative REUSS. Well, we're getting a little better now. So you agree that they should exorcise junk and repudiate their proposed 1983 monetary targets?

Mr. FELDSTEIN. No. I believe that they should in this case, as in other cases, ask themselves what the relationship is likely to be between nominal GNP and the monetary aggregates and on the basis of that consider whether adjustments should be made in the path of the monetary aggregates.

Representative REUSS. Well, yes. If they ask themselves they may come up with a wrong answer. What would you say if they asked you as a standard bearer of the administration's economic policy, which includes a mandate on M_1—what would you tell them?

Mr. FELDSTEIN. I would tell them they should examine all that evidence. I really do not think it's appropriate for me to be telling the Fed what its policy should be.

Representative REUSS. Well, thanks for very little on that one, Congressman Hawkins.

Representative HAWKINS. I have no further questions.

Representative REUSS. Senator Sarbanes.

Senator SARBANES. Chairman Feldstein, is it your view that the administration should not indicate a public judgment about the policies of the Federal Reserve, as to whether they're appropriate or not?

Mr. FELDSTEIN. I think we should not provide specific targets for monetary growth.

Senator SARBANES. That's not the question I asked.

Mr. FELDSTEIN. Well, the question you asked was should we express judgments about the Fed.

Senator SARBANES. Indicate policy judgments about the policies followed by the Federal Reserve?

Mr. FELDSTEIN. Not in a way that would interfere with the independent exercise of their judgment.

Senator SARBANES. Do you think you can indicate policy judgments about what they are doing without interfering with the independent exercise of their judgment?

Mr. FELDSTEIN. I would say over the last 2 years the Fed has generally followed an appropriate course. I think that that doesn't interfere with the decisions they will make at their next Open Market Committee. So to that extent, yes. If I said that I think in the last 3 months they have not allowed M this or M that to do this or that, and that that's inappropriate, that would be jawboning the Fed in what I regard as an inappropriate way for someone in my current position.

Senator SARBANES. I didn't ask about you. I said the administration. Do you draw a distinction between what you think you can say about a policy judgment about the Fed and what the administration can say? Does the Secretary of the Treasury, for example, have more latitude to express a policy judgment than you do?

Mr. FELDSTEIN. I'm telling you the rules that I set for myself about my own public statements.

Senator SARBANES. I know, but if you're going to set rules for yourself, that may be inappropriate. You set some rules for yourself that we had to address over the last couple of days leading to this hearing and I'm a little concerned about this self-imposed rule. That's why I'm pursuing this questioning.

Mr. FELDSTEIN. Well, you have to——

Senator SARBANES. What about the President? Let's start at the top. What about the President? Can the President express a policy judgment about the policies followed by the Federal Reserve?

Mr. FELDSTEIN. I'm not going to answer about what the President can or should do. He obviously can do what he wants to in this regard.

Senator SARBANES. Do you think the President can do what he wants?

Mr. FELDSTEIN. Don't you?

Senator SARBANES. No; I think he's bound by the laws and the Constitution.

Mr. FELDSTEIN. I agree with that.

Senator SARBANES. And he has to act accordingly.

Mr. FELDSTEIN. You're right.

Senator SARBANES. You agree with that?

Mr. FELDSTEIN. I do.

Senator SARBANES. Thank you.

Representative REUSS. Well, Chairman Feldstein, I appreciate you being here this morning and responding to the questions we asked you. Senator Jepsen and Senator Sarbanes both mentioned that prior

to your being here this morning there was a little chin bruising going back and forth between you and me and I'm delighted you're here.

Just one little thing I do want to clear up. Some of the press has had stories in writing about our interchange of the last few days culminating happily in your being here this morning. Some of the press has mentioned anonymous sources in your office as having said—and I don't know if this is so or not—that I set the tentative hearing for Monday of this week at 2 o'clock with knowledge that there was a Cabinet meeting that you had to attend. That simply is not so. If inquiry among your staff suggests that I had any such knowledge, I wish you would make it clear in the record. It's not a big point, but in the general interest of tidying things up, if I don't hear from you, I will assume that my version is correct. Very good. Good luck to you, sir.

Mr. FELDSTEIN. Thank you and I'm only sorry that you will not be in the Chair when I have the pleasure of coming here, as I hope I will soon, and saying that the economy is now in recovery rather than ready to recover.

Representative REUSS. Thank you very much.

We now stand in adjournment.

[Whereupon, at 12:20 p.m., the committee adjourned, subject to the call of the Chair.]

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